Filed 7/20/09 Hedstrom v. Truxton Radiology Med. Group CA5

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIFTH APPELLATE DISTRICT

DANIAL C. HEDSTROM,

Plaintiff and Respondent,

v.

TRUXTUN RADIOLOGY MEDICAL GROUP,

Defendant and Appellant.

F056068

(Super. Ct. No. CV-261044)

OPINION

APPEAL from a judgment of the Superior Court of Kern County. Linda S. Etienne, Commissioner.

Darling & Wilson, Joshua G. Wilson; Dake, Braun & Monje, Craig N. Braun for Defendant and Appellant.

Noriega & Associates and Robert J. Noriega for Plaintiff and Respondent.

-ooOoo-

In this appeal, we are asked to determine whether a provision in an employment agreement was a reasonable liquidated damages provision or amounted to an unenforceable penalty under Civil Code section 1671. As we shall explain, we will affirm the judgment.

FACTUAL AND PROCEDURAL BACKGROUND

Defendant Truxtun Radiology Medical Group, LP (Truxtun), which is in the business of providing comprehensive radiology services to the public in Kern County, hired plaintiff Danial Hedstrom (Hedstrom) as its director of operations. Hedstrom began his employment on November 15, 2006, and was presented with a written employment agreement that day. When Hedstrom was hired, he was 55 years old and lived in Phoenix, Arizona, but he planned on relocating to Bakersfield.

Hedstrom signed the employment agreement on February 27, 2007. Truxtun's attorney prepared the agreement, which was first used for a previous employee. The agreement was to continue for either five years, retroactive to the first day of employment, "or until the employment relationship was sooner terminated as provided in the agreement." Paragraph 2.4 set Hedstrom's starting salary at $137,500 per year which, according to paragraph 2.5, would be adjusted annually based on the Consumer Price Index. The agreement provided a benefits package, which included contributions to pension and profit sharing plans, health, dental and life insurance, a year-end bonus and vacation. The agreement gave Truxtun the right to terminate Hedstrom for cause. It also contained a provision that allowed Truxtun to terminate Hedstrom without cause, paragraph 3.2, which stated, in pertinent part: "Employer shall have the right, at any time, to terminate this Agreement upon thirty days written notice to Employee." Paragraph 3.4 allowed Hedstrom to also terminate the agreement: "Employee shall have the right, at any time, to terminate this Agreement upon thirty days written notice to Employer."

Paragraph 3.5 of the agreement provided: "<u>Payment Upon Termination</u>. In the event this Agreement is terminated by Employer without cause prior to the completion of the term of employment specified, Employee shall be entitled to continue receiving the salary specified in Section 2.4 of this Agreement. Conversely, in the event Employee should exercise Employee's right to terminate this Agreement prior to the completion of the term of employment specified, Employee shall be required to pay Employer the monthly salary specified in Section 2.4 of this Agreement. Employer and Employee have negotiated this payment as a form of liquidated damage, based upon the desire of both Employer and Employee to avoid litigation and by reason of the fact that damages resulting from any claim of wrongful termination by Employer or claim of breach of this Employment Agreement by Employee would be difficult, if not impossible to ascertain."

The agreement also contained a provision purporting to restrict employment activities after termination of employment, which stated: "4.5 Competitive Activities After Termination of Agreement. Employer and Employee are each aware of the fact that, under California Law, employers are not typically allowed to restrict employment activities of a former employee. However, notwithstanding the general prohibition as to restricting employment of a former employee, Employer and Employee each agree that appropriate restrictions are both necessary and appropriate in this case, both by reason of the fact that Employee will obtain proprietary and confidential information from Employer, as well as the fact that Employee's compensation provides benefits that are similar to these being received by a shareholder. Therefore, upon Employee's termination of employment, for any reason, Employee will not, for a period of two years, provide management services to any medical facility providing radiology services as a principal component of its business. Employee acknowledges that this restriction is a material term of this Agreement and that, absent Employee's agreement to this restriction, Employer would not hire Employee."

On April 18, 2007, Noel Cabezzas, Truxtun's chief financial officer, notified Hedstrom by letter that Truxtun was exercising its right to terminate his employment without cause under paragraph 3.2 of the agreement. A final check for services provided through that day was enclosed. At that time, Hedstrom was in the process of moving from Phoenix to Bakersfield, but he had not actually completed the move.

On June 12, 2007, Hedstrom filed a complaint for breach of the agreement, naming Truxtun as the sole defendant. Hedstrom alleged that Truxtun was obligated to continue paying his salary under paragraph 3.5 of the agreement and its failure to do so breached the agreement. A court trial was held solely on the issue of the validity of paragraph 3.5 as a liquidated damages provision. The parties stipulated that if the court found the provision valid, the liquidated damages owed totaled $594,260.27, comprised of $143,845.38 in past liquidated damages including 10 percent pre-judgment interest and $450,414.89 in prospective liquidated damages using a discount rate of four percent to discount to present cash value. Truxtun conceded it terminated the agreement on April 18, 2007 without cause pursuant to paragraph 3.2.

Gurish Patel, a general partner of Truxtun, and Cabezzas both testified that when the agreement was entered into, they did not know how long it would take Hedstrom to find new employment if his employment was terminated early, where he could find comparable employment, or how much money he could earn through comparable employment. Patel, however, had anticipated Hedstrom would find other employment if his employment was terminated early. According to Patel, Hedstrom was terminated pursuant to paragraph 3.2 of the agreement, which gave Truxtun the right to terminate the agreement on 30 days' written notice.

Hedstrom testified that before signing the agreement, he discussed paragraph 3.5 with Cabezzas to get his understanding of what it meant and what would happen if Hedstrom left or was terminated without cause. They discussed that if Hedstrom just quit one morning, it could "very much impact" Truxtun financially, particularly if he was in contract negotiations for a reimbursement contract, leaving Truxtun in the position of having to find a replacement, which could be costly and time consuming.

After receiving the parties' post-trial briefs on the issue of the enforceability of paragraph 3.5, the trial court issued a written ruling, explaining that the pivotal question was whether the amount established in the liquidated damages clause bore a reasonable relationship to the range of harm that might have been reasonably anticipated, that it was Truxtun's burden to show the provision was unreasonable under the circumstances at the time the parties entered into the agreement, and that Truxtun failed to meet its burden of proof. Judgment in Hedstrom's favor in the amount of $594,260.27 was entered on August 21, 2008. This timely appeal followed.

DISCUSSION

To avoid uncertainty and litigation if a default occurs, the parties to a contract may use a liquidated damages clause to determine the measure of damages in advance. (See *Hong v. Somerset Associates* (1984) 161 Cal.App.3d 111, 114.) Except in limited circumstances not present here, such a clause is generally valid unless the party who later seeks to invalidate it establishes it was unreasonable under the circumstances existing at the time the parties entered into the contract. (*Ridgley v. Topa Thrift & Loan Assn.* (1998) 17 Cal.4th 970, 977 (*Ridgley*); Civ. Code, § 1671, subd. (b).) A liquidated damages provision is unreasonable if the preset damage amount bears no reasonable relationship to the range of actual damages the parties could have contemplated at the time of contracting and thus does not represent the parties' reasonable endeavor to estimate a fair average compensation for any loss that may be sustained. (*Ridgley, supra*, 17 Cal.4th at p. 977.) "In the absence of such relationship, a contractual clause purporting to predetermine damages 'must be construed as a penalty'" and cannot provide the basis on which the plaintiff may avoid having to establish his actual damages in order to recover. (*Ibid.*; *Poseidon Development, Inc. v. Woodland Lane Estates, LLC* (2007) 152 Cal.App.4th 1106, 1115.) Whether a liquidated damage provision is valid or instead constitutes an unenforceable penalty presents a question of law, subject to our de novo review. (*Harbor Island Holdings v. Kim* (2003) 107 Cal.App.4th 790, 794.)

Here, the case was tried solely on the validity of paragraph 3.5 as a liquidated damages provision.[1] Truxtun does not dispute that the amount specified in paragraph 3.5 is directly tied to Hedstrom's compensation, thereby evidencing an attempt to estimate compensation for damages which might be sustained from the agreement's early termination. Truxtun, however, contends the provision constitutes a penalty because it awards Hedstrom his full salary without considering his duty to mitigate damages in the event of early termination. Pointing out that when an employee seeks damages for wrongful discharge he or she has a duty to mitigate damages, Truxtun argues a liquidated damages provision must set damages at something less than full performance to account for the non-breaching party's duty to mitigate and paragraph 3.5's failure to account for mitigation renders it an unenforceable penalty as a matter of law. Truxtun had the burden of proving the provision was *not* reasonable on this ground. (Civ. Code, § 1671, subd. (b).)

Although there may be some appeal to Truxtun's argument, as Hedstrom will not be required to mitigate his actual damages and may profit from his termination, that the damages specified equal the salary owed for the remaining term of the agreement does not necessarily mean the parties did not consider the effect of mitigation. When the parties entered into the contract, Hedstrom intended to move to Bakersfield to take the position. As evidenced by the testimony of Truxtun's general partner and its chief

---

[1] At the outset, we question whether paragraph 3.5 is even a liquidated damages provision, since the agreement expressly permits either party to terminate it at any time and therefore does not provide for payment in the event of the agreement's breach. A contract provision that authorizes payment in exchange for early termination is generally considered an alternative to performance and not a penalty. (See *Blank v. Borden* (1974) 11 Cal.3d 963, 970; *Anderson, McPharlin & Connors v. Yee* (2005) 135 Cal.App.4th 129, 134-135; *Morris v. Redwood Empire Bancorp* (2005) 128 Cal.App.4th 1305, 1314-1315.) Since the parties have not addressed this issue, either on appeal or in the trial court, and both assume the provision is one for liquidated damages, we will not decide the issue and will treat it is a liquidated damages provision.

financial officer, if Truxtun terminated Hedstrom before the agreement's five-year term expired, it was not known how long it would take Hedstrom to obtain other employment, what his potential compensation would be, or even if he would be able to obtain other employment, especially given Hedstrom's age. As the parties expressed in their agreement, the payment in paragraph 3.5 was intended to avoid litigation and the uncertainty associated with determining damages, which included Truxtun's risk that Hedstrom might not, despite reasonable efforts, be able to secure comparable employment and Hedstrom's risk he may be found to have failed to pursue every mitigation opportunity. (See, e.g., *Radisson Hotels Intern., Inc. v. Majestic Towers, Inc.* (C.D.Cal. 2007) 488 F.Supp.2d 953, 963 [concluding a non-breaching party's mitigation efforts are irrelevant to the liquidated damages analysis since the purpose of liquidated damages is to allow the parties to avoid the cost, difficulty and delay of proving damages.])

In addition, the parties could have considered the impact of the non-competition provision in paragraph 4.5, which precluded Hedstrom from obtaining comparable employment for two years, in estimating the amount of liquidated damages. We do not agree with Truxtun, who asserts the provision is void as against public policy, that we cannot consider this provision in determining whether the liquidated damages are reasonable. Regardless of its validity, the existence of the provision certainly factors into the damages the parties contemplated at the time they entered into the agreement. If the provision is not enforceable, Hedstrom was still at risk that Truxtun would attempt to enforce it, thus requiring him to defend against it, and the mere existence of the provision could discourage future potential employers from employing him.

While the parties certainly could have reached a different calculation for the damages awarded in paragraph 3.5, that they did not do so does not render the damages unreasonable. Even with the damages set as they are, given Truxtun's uncertainty regarding the extent Hedstrom would be able to mitigate his damages, the damages bear a reasonable relationship to the range of anticipated losses. This is particularly true in light of the other potential losses not covered by the lost salary awarded by paragraph 3.5, such as lost salary adjustments, insurance (health, dental and life), year-end bonuses and the right to participate in Truxtun's retirement plans, which apparently included employer contributions. While Truxtun asserts these items should not be considered because they were not guaranteed benefits, they still remained potential losses that the parties reasonably could have factored into the liquidated damages determination at the time they entered into the agreement.

In sum, the provision here is a reasonable endeavor to ascertain in advance what the damages would be from a wrongful discharge. The damages are not penal, they are reasonably proportionate to the loss, and the trial court was correct in holding the parties to their bargain.

For the first time on appeal, Truxtun contends Hedstrom cannot rely on paragraph 3.5 because the entire agreement is void due to the unenforceability of the non-competition provision of paragraph 4.5. Truxtun reasons as follows: (1) the non-competition provision is void because it constitutes a direct restraint on Hedstrom's profession and violates Business and Professions Code section 16600; (2) the severability provision in paragraph 5.3 states that an invalid provision shall not affect the validity of the whole agreement unless the invalid provision is a material term of the agreement; and (3) because paragraph 4.5 states that it is a material term of the agreement, under paragraph 5.3, its invalidity voids the entire agreement, including the liquidated damages provision in paragraph 3.5.

Hedstrom correctly argues that Truxtun waived this argument by failing to raise it below. (*Richmond v. Dart Industries, Inc.* (1987) 196 Cal.App.3d 869, 874, 879.) Although a litigant may change its legal theory on appeal when the new theory presents a question of law to be applied to undisputed facts (*Nippon Credit Bank v. 1333 North Cal. Boulevard* (2001) 86 Cal.App.4th 486, 500), the question of the enforceability of the agreement is disputed. In fact, Truxtun attempted to enforce the agreement by filing a cross-complaint against Hedstrom for its breach, which it ultimately dismissed before trial without prejudice, and sought attorney fees against Hedstrom at trial pursuant to the agreement. (See *Ford Motor Credit Co. v. Hunsberger* (2008) 163 Cal.App.4th 1526, 1531.)

Moreover, there are factual issues involved that the parties did not litigate due to Truxtun's failure to raise this issue below. As Hedstrom points out, even if paragraph 4.5's unenforceability invalidates the entire agreement, a court nevertheless may enforce an agreement that is illegal or violates public policy when “““effective deterrence is best realized by enforcing the plaintiff's claim rather than leaving the defendant in possession of the benefit; or the forfeiture resulting from unenforceability is disproportionately harsh considering the nature of the illegality.””” (*Maudlin v. Pacific Decision Sciences Corp.* (2006) 137 Cal.App.4th 1001, 1013.) The aim is to prevent the guilty party from reaping the benefit of his wrongful conduct. “In each case, how the aims of policy can best be achieved depends on the kind of illegality and the particular facts involved.””” (*Ibid.*) By failing to raise this issue below, Hedstrom was deprived of the opportunity to present evidence as to why the agreement should be enforced despite any violation of public policy. Accordingly, we find Truxtun has waived this contention.

DISPOSITION

The judgment is affirmed. Hedstrom is awarded his costs on appeal.

Gomes, J.

WE CONCUR:

Cornell, Acting P.J.

Dawson, J.